

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON PORT ST. JOHN'S MUNICIPALITY

## REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the accompanying consolidated and separate financial statements of Port St. John's Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2011, and the consolidated and separate statement of financial performance, statement of changes in net assets and cash flows statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to ....

### Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA) as well as for such internal control as management determines necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these consolidated and separate financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and General Notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis of qualified opinion**

### **Unauthorised, irregular, fruitless and wasteful expenditure**

7. The municipality incurred fruitless and wasteful expenditure as a result of interest and penalties arising from late payments of supplier invoices and taxes due to the South African Revenue Service (SARS). Differences amounting to R 442 214 have been noted between the interest per the financial statements after adjustments and the interest per the confirmations received, which results in me not being able to confirm the completeness of an amount of R866 063 as disclosed in note 21.1 to the financial statements.
8. Irregular expenditure of R2,2 million, incurred in contravention of the Supply Chain Management (SCM) legislation and the municipality's own SCM policy is disclosed in note 21. Management disclosed only the irregular expenditure detected during the audit and did not attempt to identify all of the expenditure incurred in contravention of the SCM prescripts. Additional procedures revealed a further irregular expenditure of R4.3 million that has not been disclosed. In these circumstances it was not possible to obtain sufficient appropriate evidence that all irregular expenditure that should have been disclosed was disclosed.
9. Unauthorised expenditure of R778 200 resulting from the use of conditional grant funding for purposes other than the intended, is not included in the unauthorised expenditure of R8.8 million disclosed in note 21.2. As a result the unauthorised expenditure disclosed is understated by R778 200.

### **Trade and other Payables**

10. Included in the Trade and other Payables balance of R49.9 million is an amount of R10 million which could not be agreed to supporting invoices. Furthermore the completeness of this balance could not be confirmed as the municipality does not have a proper system to record invoices from creditors. I also identified unrecorded creditors amounting to R2.6 million during the audit. Management was given an opportunity to adjust the financial statements, however, a further R1.4 million was identified. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of the Trade and other Payables balance of R49.9 million as disclosed in the statement of financial position and in note 3 even after performing alternative procedures.
11. Furthermore, Payroll creditors of R5.2 million relating to pay-as-you-earn (PAYE), unemployment insurance deductions and skills development levy are included in the Trade and other Payables of R49,9 million disclosed in note 3 to the financial statements. An unexplained difference of R510 932 between the amount disclosed in the financial statements and the confirmation obtained from SARS was noted. In addition to this, a difference of R522 000 between the payroll reports and the returns submitted to SARS was also identified. My recalculations of the PAYE deductions based on the SARS tables and the payroll reports also revealed significant differences. In these circumstances I was unable to obtain sufficient appropriate evidence relating to the existence, completeness and valuation of the Payroll creditors of R 5.2 million included in Trade and other Payables disclosed in the statement of financial position and note 3.
12. I have also done a recalculation of the PAYE deductions from employees for the year and incorrect calculations were noted. Differences amounting to R577 765 have been identified between the PAYE charged to employees and the PAYE due per the SARS tax tables for the period.

13. An amount of R754 328 disclosed as part of the Trade and other Payables balance of the entity, could not be supported with valid documentation. I was therefore unable to confirm the completeness of the amount of R754 328 disclosed as part of Trade and other Payables.

#### **VAT Receivable**

14. I could not verify the accuracy and completeness of the value-added tax (VAT) balance of R10.9 million disclosed in the statement of financial position and in note 9 to the financial statements as it did not reconcile to the confirmation received from SARS. An unexplained difference of R6 million was identified. I could not confirm the validity of the difference of the reconciling item even after performing alternative procedures. As a result I was unable to obtain sufficient appropriate audit evidence relating to the completeness, existence and valuation of the VAT balance of R10,9 million disclosed in the statement of financial position and in note 9.
15. Furthermore, no supporting documentation could be provided for an amount of R490 646 disclosed as part of the VAT receivables balance in the financial statements of the entity.

#### **General expenditure**

16. Included in the expenditure amount of R41 million for the entity, is an amount of R2,6 million which could not be audited as a breakdown of the balance was not provided.

#### **Accumulated surplus**

17. An amount of R16,1 million is included twice in the calculation of the accumulated surplus. As a result the accumulated surplus is overstated by this amount. Due to a lack of information it was not possible to verify which class of transactions or account balance was affected by the corresponding leg of this entry.
18. In addition an amount of R1,3 million as disclosed in the financial statements could not be supported with valid supporting documentation. Furthermore an amount of R919 412 disclosed as a prior year error could not be agreed to valid supporting documentation.

#### **Unspent conditional grants**

19. Unspent conditional grant balance in the consolidated financial statements has been understated by R1,9 million relating to projects moneys unspent as disclosed in the agency's separate financial statements.

#### **Commitments**

20. No contract management system was in place for the identification and recognition of contracts. During the audit I identified commitments amounting to R3,1 million that were not included as part of commitments disclosure in the financial statements and after management had the opportunity to adjust the financial statements and go through the whole population, a further R21,8 million of undisclosed commitments was identified. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to

obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R23,4 million (2010: R16,8 million), as stated in note 22.5.

#### **Aggregation/ Accumulation of immaterial uncorrected misstatements**

21. The financial statements as a whole are materially misstated due to the cumulative effect of various individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the disclosures to the financial statements:

- Leave paid to employee who did not serve notice – R40 427
- Overtime paid more than 30% of monthly salary – R17 528
- Incorrect depreciation calculation - R65 275
- Vat incorrectly calculated – (R293 689)
- Conditional grants opening balance does not agree to last year's figure – R1 599
- Incorrect payments made to employees on termination – R860
- Contingent liability relating to VAT payable to SARS – R400 000
- Provision for leave pay overstated – R113 412
- Differences between the trial balance and the financial statements relating to Cash and cash equivalents – R60 447

In addition, I was unable to obtain sufficient appropriate audit evidence and I was consequently unable to confirm or verify the following elements making up the statement of financial position, the statement of financial performance and the disclosures to the financial statements:

- Account payable (UIF for councilors) – R265 579
- Completeness of traffic income – R22 800
- Bank and cash – (R5 316)
- Allowances paid with no supporting documentation – R106 893
- Consumer debtors overstatement in the financial statements – R166 823
- Payroll reports for salaries paid amounting to – R384 410
- Revenue (implementer's fees) with no supporting documentation – R135 829

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

#### **Opinion**

22. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the consolidated financial statements present fairly, in all material respects, the financial position of the Port St. Johns Municipality as at 30 June 2011 and its financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

I draw attention to the matters below. My opinion is not modified in respect of these matters:

### **Going concern**

23. The municipality has prepared the financial statements on a going concern basis. Note 30 to the financial statements indicates that there are a number of indicators that the municipality's sustainability is under threat. These include:

- Revenue not collected
- Creditors not paid
- The budget is overspent

### **Material losses/ Impairments**

#### **Material impairments**

24. The municipality has receivables of R11.5 million disclosed in note 8 of the financial statements at 30 June 2011, which have been outstanding for more than 12 months. The recoverability of these receivables is doubtful and hence these have been impaired in the financial statements.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

25. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

### **Predetermined objectives**

#### **Usefulness of information**

The following criteria are relevant to the findings below:

- Consistency: Objectives, indicators and targets are consistent between planning and reporting documents
- Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets
- Measurability: Indicators are well-defined and verifiable, and targets are specific, measurable and time-bound

### **Reported objectives/indicators/targets/are not consistent when compared with the planned objectives, indicators and targets (Consistency)**

26. Reported performance against predetermined objectives, indicators and targets is not consistent with the approved integrated development plan.

### **Planned and reported indicators are not well defined (Measurability)**

27. For the selected objectives, 30% of the planned and reported indicators were not clear, as well defined data definitions were not available to allow for data to be collected consistently.

### **Reliability of information**

The following criterion is relevant to the finding below:

- Validity: Actual reported performance has occurred and pertains to the entity

### **The validity of reported performance against indicators could not be confirmed as inadequate supporting source information was provided (Reliability)**

28. For the selected objectives the validity of 45% of the reported indicators and targets could not be established as sufficient appropriate audit evidence and/or relevant source documentation could not be provided.

### **Compliance with laws and regulations**

Included below are findings on material non-compliance with laws and regulations applicable to the municipality:

### **Strategic and performance management**

29. The municipality did not adopt and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by sections 38, 39, 40 and 41 of the Municipal Systems Act and Municipal Planning and Performance Management Regulations 7 and 8.

### **Budget**

30. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the Municipal Finance Management Act.
31. The mayor did not submit all quarterly reports to council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the Municipal Finance Management Act.
32. The accounting officer did not always submit the monthly budget statements to the mayor and/or the relevant provincial treasury, as required by section 71(1) of the Municipal Finance Management Act.
33. Unforeseeable and/or unavoidable expenditure not provided for in the annual budget was incurred but was then not appropriated in an adjustment budget, as required by section 29(2)(d) of the Municipal Finance Management Act.

### **Annual financial statements and annual report**

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of capital assets, current liabilities, revenue, expenditure and disclosure items identified by the



auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

#### **Audit committees**

35. The audit committee did not function as required by section 166 of the Municipal Finance Management Act, in that it did not respond to the council on any issues raised by the Auditor-General in the audit report;

#### **Procurement and contract management**

36. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) & (c).
37. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
38. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services as per the requirements of SCM regulation 27(2)(a).
39. Invitations for competitive bidding were not always advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) & 22(2).

#### **Expenditure management**

40. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
41. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised expenditure when it was incurred, as required by section 65(2)(b) of the MFMA..
42. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

#### **Transfers and conditional grants**

43. Sufficient appropriate audit evidence could not be obtained that conditional grant allocations were used for the purposes stipulated in their respective schedules as required by section 15(1) of the DoRA
44. The municipality did not always submit monthly reports to the transferring national officer, the National Treasury and the Provincial Treasury on spending and financial performance in respect of the allocations received as required by section 11(2)(b) of the DoRA and section 71(5) of the MFMA

45. The accounting officer did not evaluate the performance of the municipality in respect of programmes funded or partially funded by a schedule 4 allocation within two months after the end of the financial year as required by section 11(6) of the DoRA.

### **Asset management**

The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

### **INTERNAL CONTROL**

46. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

47. The administrative leadership does not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls as evidenced by the number of non-compliance with legislation items noted and the misstatements identified both corrected and uncorrected.
48. Management have documented policies and procedures to guide the operations of the municipality, however these policies were not properly implemented resulting in numerous instances of noncompliance with the MFMA and Supply Chain Management.
49. Management has not implemented effective HR management practices to address the high vacancy rate and ensure that adequate and sufficiently skilled resources are in place.
50. Management has also not established an IT governance framework that supports and enables the business, delivers value and improves performance of the municipality.
51. Although the municipality has a functioning audit committee which reported to the council, and internal audit unit, significant misstatements have been identified during the current year audit due to non-implementation of recommendations by the municipality. The Audit Committee and Internal Audit are not supported by leadership and their reports were not taken seriously and not addressed or acted upon.

### **Financial and performance management**

52. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting and this resulted in delays in submission of information and requested information was not available and supplied without any significant delays. The unavailability of information as well as the late submission has resulted in significant delays to the audit process. The closure of the municipal office has also led to disruption and delay in the audit process.



53. Manual or automated controls are not design to ensure that the transactions have occurred, are authorised and completely and accurately processed, this resulted in the municipality incurring irregular as well as fruitless and wasteful expenditure as disclosed in the financial statements.
54. Management has not implemented proper policies to identify and record transactions when they occur and the financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.; this is evidenced by the many unrecorded liabilities identified during the audit and the issue of completeness of some of the major creditors of the municipality.
55. Regular review and monitoring of compliance with laws and regulations has not been confirmed during the audit as evidenced by the reported non-compliance paragraphs noted above.

## **OTHER REPORTS**

### **Investigations**

56. An investigation into the alleged misconduct by the previous Municipal Manager and Chief Financial Officer is still in progress.

*Auditor-General.*

East London

20 December 2011



**AUDITOR-GENERAL  
SOUTH AFRICA**

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